

# Washington University Law Review

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Volume 25 | Issue 4

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January 1940

## Corporations—Merger—Right of Holder of Cumulative Preferred Stock to Accrued Dividends

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### Recommended Citation

*Corporations—Merger—Right of Holder of Cumulative Preferred Stock to Accrued Dividends*, 25 WASH. U. L. Q. 614 (1940).

Available at: [https://openscholarship.wustl.edu/law\\_lawreview/vol25/iss4/11](https://openscholarship.wustl.edu/law_lawreview/vol25/iss4/11)

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national conditions may lead the courts to validate extended indirect invasions of the immunities contained in the Bill of Rights. Subsequent decisions will reveal whether this undesirable possibility will be actualized.

J. R. S.

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**CORPORATIONS—MERGER—RIGHT OF HOLDER OF CUMULATIVE PREFERRED STOCK TO ACCRUED DIVIDENDS—[Delaware].**—A corporation, by vote of 91.8% of its total stock, adopted a plan to merge with its wholly owned subsidiary. Under the plan one share of \$3 cumulative preferred stock and six shares of no par value common stock in the new company were to be exchanged for each share of the old \$6 cumulative preferred stock and \$29 accrued, unpaid dividends. The parent corporation had at the time a surplus, unearned but available for dividends, which was more than sufficient to pay the accumulated preferred dividends. This surplus was to be capitalized and given to the preferred stockholders. Delaware statutes existing at the time the corporation was created authorized the merger of parent corporation with subsidiary and the adoption of a plan for converting the stock of the old corporation into that of the new.<sup>1</sup> Such a plan had to be adopted by a two-thirds vote of all stockholders and all "rights of creditors \* \* \* all debts, liabilities and duties" and "all the restrictions, disabilities and duties of each" were to survive against the resulting corporation.<sup>2</sup> The plaintiffs, holding shares of the old \$6 cumulative preferred stock, brought a bill in equity to have the merger declared void insofar as it would convert their stock into other securities without paying the accrued dividends. *Held*, that the merger statute, which was automatically a part of the contract between stockholder and corporation, authorized two-thirds of the stockholders at any time to effect a merger and to alter, under a fair and equitable plan, the rights of preferred stockholders to accumulated unpaid dividends as well as to future preferences. Plaintiffs were also held to be barred by laches.<sup>3</sup>

The court's task was to construe the merger statute to determine whether the legislature had intended to foster mergers to the extent of allowing the corporation to make a fair and equitable adjustment of existing claims by commuting accrued dividends into common stock rather than compelling literal compliance with the terms of the stock contract.<sup>4</sup> In previous cases, where the changes had been attempted under a statute authorizing charter amendments, the same court had refused to allow abrogation of the right to preferred cumulative dividends already accrued, but did allow it as

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sible unpredictable judicial action serves only to emphasize that the courts cannot be relied upon as the bulwark of civil liberties and that preservation of civil liberties fundamentally rests upon the vigilance of the citizenry acting through the legislature.

1. Del. Revised Code (1935) secs. 2091, 2091A.

2. Del. Revised Code (1935) sec. 2092.

3. Federal United Corp. v. Havender (Del. 1940) 11 A. (2d) 331.

4. Literal compliance with the terms of the contract would require payment of all accrued dividends before any other class of stockholders might participate in profits.

to those rights not yet "matured by time."<sup>5</sup> Those which had accrued were said to be "vested rights,"<sup>6</sup> "in the nature of a debt,"<sup>7</sup> or "present property interests."<sup>8</sup> Unless a difference in legislative intent was evident in the merger statute, it would seem that the court would feel bound in the instant case again to protect the accrued rights of the preferred stockholder. Although the language of the charter amendment statute seems to grant the corporation greater power to alter the stock contract than does the merger statute,<sup>9</sup> the inherent nature of mergers may call for a more liberal interpretation of that statute. Few mergers would be effected where one corporation was subject to an irremovable charge on its future profits and the stockholders of the other would have to wait until all the arrearages had been paid before sharing in the profits of the resulting corporation.<sup>10</sup> Moreover, the distinction made in the previous cases between accrued dividends and future preferences does not seem necessary;<sup>11</sup> each is merely a

5. *Morris v. American Public Utilities Co.* (1923) 14 Del. Ch. 136, 122 Atl. 696; *Keller v. Wilson & Co.* (Del. 1936) 190 Atl. 115; *Consolidated Film Industries v. Johnson* (Del. 1937) 197 Atl. 489.

6. *Morris v. American Public Utilities Co.* (1923) 14 Del. Ch. 136, 122 Atl. 696, 704; *Keller v. Wilson & Co.* (Del. 1936) 190 Atl. 115, 125. See also *General Inv. Co. v. American Hide & Leather Co.* (1925) 98 N. J. Eq. 326, 340, 129 Atl. 244, 44 A. L. R. 60; Berle and Means, *The Modern Corporation and Private Property* (1932) 268.

7. *Morris v. American Public Utilities Co.* (1923) 14 Del. Ch. 136, 122 Atl. 696, 704; *Keller v. Wilson & Co.* (Del. 1936) 190 Atl. 115, 125. Cf. *Roberts v. Roberts-Wicks Co.* (1906) 184 N. Y. 257, 77 N. E. 13, 3 L. R. A. (N. S.) 1034, 112 Am. St. Rep. 607, 6 Ann. Cas. 213.

8. *Morris v. American Public Utilities Co.* (1923) 14 Del. Ch. 136, 122 Atl. 696, 704. See also *General Inv. Co. v. American Hide & Leather Co.* (1925) 98 N. J. Eq. 326, 340, 129 Atl. 244, 44 A. L. R. 60. See Berle and Means, *The Modern Corporation and Private Property* (1932) 268; Note (1937) 4 U. of Chi. L. Rev. 645, 647.

9. The amendment statutes before the court in *Consolidated Films Industries v. Johnson* (Del. 1937) 197 Atl. 489 authorized "changing the number, par value, designations, preferences, or relative, participating, optional or other special rights of the shares, or the qualifications, limitations or restrictions of such rights." Del. Revised Code (1935) sec. 2058. The merger statute merely authorizes an agreement prescribing "the manner of converting the shares of each of the constituent corporations into shares of the consolidated corporation," and furthermore provides that the resulting corporation is to be "subject to all the restrictions, disabilities, and duties of each of such corporations so consolidated or merged" and that all "rights of creditors \* \* \*, and all debts, liabilities and duties of the respective constituent corporations shall thenceforth attach to said resulting or surviving corporation \* \* \*." Del. Revised Code (1935) secs. 2091, 2092.

10. But these considerations do not apply in the instant case since the parent corporation merged with its wholly owned subsidiary and no capital reconstruction was necessary. In the original trial of the case the chancellor had held that the scheme was not a true merger but a mere reclassification of shares. "If what the defendant did will stand the test of legal legitimacy, \* \* \* all a corporation needs to do to escape the results of the law as laid down by our Supreme Court, is to create a subsidiary for itself and then proceed to absorb it by merger." *Havender v. Federal United Corp.* (Del. Ch. 1938) 2 A. (2d) 143, 147, aff'd (Del. Ch. 1939) 6 A. (2d) 618.

11. See Berle and Means, *The Modern Corporation and Private Property* (1932) 268-269; Note (1937) 46 Yale L. J. 985, 989.

claim to participate in future profits in advance of common stockholders.<sup>12</sup>

The dispute is essentially one between preferred and common stockholders over the distribution of future profits. To force the preferred stockholder to relinquish his preferred rights and assume the status of a common stockholder is, of course, to deprive him of a valuable security device. On the other hand, the preferred stockholder receives in lieu of cash the equivalent of a stock dividend, which can be converted into cash if there is a ready market.

The court emphasized the point that the merger plan was fair and equitable. For the plan to be fair and equitable to the preferred stockholders, it should give compensation for their contract rights to priority in the distribution of future profits.<sup>13</sup> On the other hand, since the profits have not been, and may never be, earned, they are not entitled to be paid the full arrearages in cash. An equitable plan would compensate them for loss of priority in the distribution of dividends by giving them a greater proportionate share through ownership of common stock. The court has assumed the difficult task of determining whether the amount of stock given is a fair settlement, taking into consideration the situation of the company and its prospects for future profits.<sup>14</sup>

W. B. W.

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FEDERAL PRACTICE—RAISING NEW ISSUES ON APPEAL—BOARD OF TAX APPEALS—[Federal].—The Commissioner of Internal Revenue, applying section 166 of the Revenue Act of 1934,<sup>1</sup> held taxable the income from three irrevocable short-term trusts executed by the taxpayer for the benefit of his children. On appeal by the taxpayer to the Board of Tax Appeals, the Commissioner relied on sections 166 and 167 of the Revenue Act of 1934.<sup>2</sup> The Board entered its decision, holding that there were no deficiencies in the return of the taxpayer. The Commissioner appealed to the Supreme Court, assigning error in the Board's application of sections 166 and 167,

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12. See Note (1937) 46 Yale L. J. 985, 989.

13. In the typical situation, the preferred stockholder has had to forego his dividends during times of depression. When business has improved, he is asked by the common stockholders to give up his priority rights so that they may share immediately in profits. Unless the clearing away of arrearages attracts further capital investment which increases profits, such a plan benefits the common stockholders at the expense of the preferred.

14. In the instant case it would seem that the preferred stockholders were adequately protected. The unearned surplus existing at the time of the merger was capitalized and given to them. The fact that a large majority of the preferred stockholders voted in favor of the plan should not, however, be given too much weight in determining the question of fairness of the settlement. Many of the preferred stockholders probably held common stock which they hoped to benefit thereby. Furthermore, the management, usually a large holder of common stock, has a tremendous influence through the solicitation of proxies. See Note (1937) 4 U. of Chi. L. Rev. 645.

1. Revenue Act (1934) 48 Stat. 680, c. 277, 26 U. S. C. A. (1940) secs. 166, 167, and 22 (a).

2. Jay C. Hormel (1939) 39 B. T. A. 244.